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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0084
Corporate Income Tax
For The Period: 1990 Through 1993

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Corporate Income Tax: Student Loan Marketing

Authority: IC 6-2.1-3-1; Information Bulletin #19

The taxpayer protests the disallowance of its deduction of interest income.

II. Corporate Income Tax: Apportionment of Payroll on a Mileage Basis

Authority: IC 6-3-2-2; 45 IAC 3.1-1-49

The taxpayer protests the disallowance of the apportionment of payroll on a mileage basis.

III. Corporate Income Tax: Indiana Sales Numerator

Authority: IC 6-3-2-2

The taxpayer protests the "throwback" of income to Indiana.

STATEMENT OF FACTS

The taxpayer owns and operates a variety of businesses. Given the diverse nature of the companies, equipment, holdings, etc., at issue, specific facts that are salient to the discussion will be provided as

needed below.

I. Corporate Income Tax: Student Loan Marketing

DISCUSSION

For the years at issue, the taxpayer was disallowed its deduction for interest income received from investments in a "student loan marketing association" (hereinafter "SLMA"). The taxpayer believes that the auditor mistakenly confused the SLMA bonds with the Federal National Mortgage Association bonds. The taxpayer argues that the interest is exempt, since it was derived directly from United States Government Obligations.

Indiana Income Tax Information Bulletin #19, which deals with governmental obligations, sheds light on the issue:

> [O]bligations issued by the following organizations are considered direct United States Government obligations [and are] specifically exempted from state income taxation by federal law. [An enumerated list follows]
>
> 22.) Student Loan Marketing Association (20 U.S.C. Section 1087-2).

FINDING

The taxpayer is sustained to the extent that the interest can be verified to be from SLMA interest.

II. Corporate Income Tax: Apportionment of Payroll Based on Mileage

DISCUSSION

For clarity and anonymity purposes, letters (e.g., "X") will designate the companies at issue in this portion of the protest. Two subsidiaries—companies C and P—of company N, employed drivers to be leased to company V and company T. V and T are also subsidiaries of company N. The source of income of C and P was from the leasing of its drivers and equipment to be used by V and T in interstate commerce. (*Taxpayer Letter, 10/15/97*).

Whether or not C and P can apportion their payroll using the mileage percentage turns on the issue of public transportation. Are C and P providing public transportation? C and P did not derive their income from *engaging* in public transportation. Instead, drivers and equipment and equipment were *leased* to V and T.

This distinction is supported by case law. In Indiana Dept. of State Revenue v. E.W. Bohren, Inc., 178 N.E.2d 438, 440 (Ind. 1961), the Indiana Supreme Court stated the following regarding a lease situation:

> It appears to us that appellee's income is not derived from operating a truck line or carrier in interstate commerce, but rather the receipts are received as a result of the appellee's property and equipment under a contract or lease to an interstate carrier.

C and P are not in the interstate trucking business for the protest at hand; instead, V and T are. All C and P are doing is leasing their drivers and equipment to interstate carriers.

The taxpayer argues in the alternative that 45 IAC 3.1-1-49 is applicable along with IC 6-3-2-2(l). The pertinent language that the taxpayer picks up from 45 IAC 3.1-1-49 is the following:

> Employees engaged in the transportation of persons and/or materials as part of the taxpayer' regular business activities, i.e., truck or bus drivers, shall have their wages assigned to this state based on miles traveled in this state.

The invocation of this regulation presupposes that C and P are engaged in public transportation, and that this is part of C and P's regular business activities. But as the above analysis has shown, in the case at hand C and P are in the leasing business.

The Apportionment Schedule for Interstate Transportation (Schedule E-7), also reflects this distinction on Line 19:

> Enter rents paid during the tax period for movable transportation revenue producing property rented and/or purchased through a lease contract, less any sub-rentals. Rented/leased property is valued at eight (8) times its annual rental rate.
>
> Purchased transportation, defined as "the taxpayer's use of motor vehicle owned and operated by … for which a charge is incurred," is included in the calculation of rented property . . . [W]hen the charge for the use of such purchased property cannot be separated from the charge for compensating the operator of the property, the value of the total charge is reduced by 20%. CAUTION: The 20% attributable to compensating the operator should *not be included in the payroll factor*. (Emphasis added)

FINDING

The taxpayer's protest is denied.

III. Corporate Income Tax: Indiana Sales Numerator

DISCUSSION

The auditor made adjustments of the sales numerator for two subsidiaries of the taxpayer. The auditor contends that neither subsidiary has "payroll or property in any state except Indiana" and that all income should be attributed to Indiana.

The taxpayer argues that the auditor has an "erroneous understanding of the facts", stating that the subsidiaries do in fact have nexus with other states. According to the taxpayer, the two subsidiaries had payroll and property outside of Indiana and post-sales activities outside Indiana. To quote the taxpayer:

> These companies [the two subsidiaries] did have payroll and property outside of Indiana and due to their activities had nexus with many other states. [The two subsidiaries] also were included in income tax returns filed in several states, including California, Illinois, Minnesota, New Hampshire, Ohio, Oregon, and Utah.

(*Taxpayer Letter, 6/22/00*).

The taxpayer also states that the two subsidiaries "have activities in several states that would create nexus and, thus give those states jurisdiction to tax these activities." (*Taxpayer Letter, 10/15/97*). The taxpayer concludes:

> The sales to these states should be included in the sales numerators of those states and not to Indiana. Taxpayer believes these sales are not subject to Indiana throwback rules and should be removed from the Indiana numerator.

(Ibid.).

Indiana's "throwback" rule is provided for in Indiana Code 6-3-2-2. Throwback issues can arise when sales are made to a purchaser in another state and the taxpayer is not subject to tax or jurisdiction in that other state. Indiana Code 6-3-2-2(n) states:

> For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:
>
> (1) in that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or

(2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

The taxpayer argues that the two subsidiaries are "included in unitary filings in several states" and subject to taxation in several states. However, a unitary filing in another state does not necessarily mean that the subsidiaries, which are included within the unitary group, are subject to tax in that state. Nor does it mean that they are subject to that state's taxing jurisdiction. Tax Policy Directive #6 clarifies this:

> The basic premise in filing combined/unitary returns is that all activities carried on by separate entities are part of a single unitary business . . . [California's treatment of the issue is explained] [In conclusion] Corporations not filing combined/unitary returns in Indiana will continue to apply the throwback sales rule in the normal fashion.

Some of the members of the unitary group, specifically the two subsidiaries, were not (per the auditor) subject to taxation in any state but Indiana. And a unitary return was not filed for the state of Indiana. Thus, the throwback rule applies.

FINDING

The taxpayer's protest is denied.

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